

# Cities and Competitiveness

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## 1 Introduction

Improved competitiveness, as we all know, is the path to economic nirvana. Plainly, it is a sought after property of any economy: the term trips frequently off the lips of politicians and commentators on economic and business matters. As cities increasingly engage in competition with one another at different levels, the determinants of competitive advantage are coming under intense scrutiny. Many an economic development strategy – whether at national, regional or urban level – starts from the premise that ‘something can be done’ to make an economy more competitive. There is a high-powered *Competitiveness Advisory Group* which reports to the European Commission (Jacquemin and Pench, 1997); the US has a special Commission for competitiveness and the UK government produced a succession of White Papers on the subject in the 1990s. In the latest, the new Labour government highlights the need for the ‘right local environment for business success’ (Department of Trade and Industry, 1998). The OECD (1996, 1997a, 1997b) too has published a series of reports on the subject, looking particularly at new industries. But there is precious little agreement either on what the term ‘competitiveness’ means or on how policy should aim to enhance it. Yet most people have an instinctive understanding that some economies function better than others and that there are systematic reasons for this. We know one when we see one, but it is difficult to define an elephant.

It tends to be taken for granted that some cities have lost their competitive edge, although it is less obvious what variables demonstrate this. In many parts of the world, major cities that were the powerhouses of their respective economies have lost ground substantially. The decline of traditional manufacturing or mining lies behind the relative decline of many of the ‘rustbelt’ cities of the North and East of the US or the old industrial cities of Northern Europe. The poor economic performance and growing social problems of many British cities, especially over the last three decades, has prompted searching questions about their competitiveness and whether or not they specialise in the ‘right’ sorts of activities.

It can also be argued that globalisation, advances in information technology and far-reaching structural change have altered the terms of competition between cities (Jensen-Butler et al, 1997). Jockeying for position between the large financial centres such as London, New York and Tokyo has been recognised for some time (Sassen, 1991; Frost and Spence, 1992). European integration impels cities to be more alert to the opportunities and threats that arise from establishment of the single market (Lever, 1993; Cheshire and Gordon, 1995). An implication of these changes is that urban hierarchies are shifting radically, with the result that cities which might have been comfortable with an allotted role (whether based on central-places or some other tidy structure) now have to confront a more precarious and uncertain development path. Where there is competition for investment and income, absolute rather than comparative advantage becomes the watchword.

Many of the factors that influence urban performance derive from national or supranational economic trends, and are thus ‘top-down’. As a result, there is little that the individual city can do to affect these variables, although (see Kresl, 1995) there are many aspects of policy that a city can control and

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<sup>1</sup> I am grateful to participants in the ESRC ‘Cities: competitiveness and cohesion’ research programme for comments on a seminar given at the University of Reading. Notes produced by Ian Gordon and an excellent bibliography on competitiveness compiled by Gareth Potts, both of the University of Reading, were useful in developing this paper.

which bear on its competitiveness. Equally, the performance of the cities in a country will have a considerable bearing on its overall economic success, so that the efficiency and well-being of the urban system are of national concern. It is also important to recognise at the outset that the bulk of any city's trading will be with other cities in the same country, so that its competitive success will reflect how it fares relative to other cities in the country rather than its international standing.

The aim of this paper is to look behind the glib notion of competitiveness in an attempt to identify what it is about cities that makes some more competitive than others. As with most things that are obvious it quickly becomes apparent that competitiveness is, in reality, a very slippery concept. Intuitively, it concerns the supply-side of the economy, yet fiscal and monetary policy (the demand-side) can have a major impact on key variables such as the exchange rate, the interest rate, the overall tax burden and labour costs.

The next section tries to make sense of the concept of competitiveness. This is followed by a discussion of the factors that bear on the performance of cities. The concluding sections bring the arguments together to offer a model of urban competitiveness and discuss the policy implications.

## **2 Making sense of competitiveness**

The vagueness of a concept open to multiple interpretations has led to confusion in the policy debate (Francis, 1989, but if only because so many policy initiatives are undertaken in its name, it is important to appraise the different senses in which the term 'competitiveness' is used. At one level it is equated, usually loosely, with the 'performance' of an economy, an absolute measure. At another, because it relates to competition, it implies a comparative element, with the implication that to be competitive, a city has to undercut its rivals or offer better value-for-money. In this sense, competitiveness is essentially about securing (or defending) market-share.

Prominent economists such as Paul Krugman (1996a and 1996b) have been highly critical of the current fashion for promoting competitiveness, arguing that it is nothing more than mercantilism in sheep's clothing and, thus, a threat to free trade. Simply put, Krugman's view is that competitiveness is an attribute of *companies*, not of cities, regions, countries or continents. Others disagree: Porter (1990), in his seminal study of competitive advantage, deplors the lack of attention to competitiveness in standard international trade theory and suggests that economic analysis is diminished by this lack. He notes that: 'What became clear ... was that there was no accepted definition of competitiveness' (Porter, 1998:p. xii). Porter goes on to assert his conviction that the national environment affects the competitive position of firms, and he observes that understanding the role of the nation 'would yield some fundamental insights into the how competitive advantage was created and sustained' [p xiii]. Given the regular use of his 'diamond' model as an underpinning for local economic development strategy, the reasoning also applies to cities.

The value of Krugman's onslaughts on the notion of competitiveness is that they invite reflection on whether there is, in fact, something substantive to the concept. Intuition tells us that one city or, for that matter, any other territorial unit does 'better' than another, and we tend to equate this with competitiveness. Standard (or, at least, neo-classical) economic theory tells us that it always makes sense to specialise in what you do best and to allow free exchange. Intuitively we feel that there are ways of improving economic performance; theory asserts that departures from the Pareto optimum may temporarily benefit one party, but are collectively counter-productive.

Can all of this be reconciled, or are the perspectives so different that they constitute a dialogue of the deaf? There are two critical elements that need, first to be analysed. The first is resource utilisation. If any economy has idle factors of production, it is plainly failing to attain its potential. Specialisation may make sense but if inhibits capacity utilisation, then it detracts from performance.

The second is institutions in the widest sense of the term. In a Coasian view of the world (Coase, 1960), the organisation of productive assets in a firm gives rise to the analysis of the firm as the unit of production. Although there can be caveats about co-operation and value chains, it is fair to say that firms are competitive. But nations, regions, or cities too can be seen as collection of assets, so that it is reasonable to think in terms of the competitiveness of that bundle of assets even if Krugman is correct in advocating caution about curbs on free trade.

At the aggregate level, and with full employment of resources, competitiveness and productivity are essentially the same thing according to some economists. Again, Porter is forthright: 'The only meaningful concept of competitiveness at the national level is national productivity' [p 6]. Fagerberg (1996) has emphasised the quality of investment and use of technology, while others equate competitiveness simply with the real exchange rate (Boltho, 1996), which implies either the use of ultimately damaging competitive devaluations or aggressive wage cutting. Analytically, the quest for competitive advantage by lowering labour costs is very similar to devaluation as it amounts to a transfer of welfare from the workers employed in production to consumers, some of whom will be in other countries, or to profits. Nevertheless, Ciampi (1996) argues that:

'competitiveness is not a "zero sum game". In other words, an increase in competitiveness in one country does not come at the expense of another. On the contrary, gains in productivity and efficiency in different countries can and must be integrated and mutually reinforcing.'

The same could be said of cities or of regions within *and* between countries. It has to be emphasised, however, that this is true only when GDP growth is higher than productivity growth. Failing this, there is simply a redistribution of market shares with winners and losers, as well as labour saving and more unemployment - a 'widening' of capacity rather than a 'deepening' of productivity).

It could be argued that sub-national economies - be they regions or cities - reflect national (or EU-level) attributes, but that they exhibit them to differing degrees. Looking at the EU as a whole, Ciampi (1996) lists the following weaknesses or causes for concern:

- institutional fragmentation
- market fragmentation
- costly or inefficient infrastructure
- limited diffusion of new technologies and innovation
- inadequate human resource development
- inflexible labour use

High labour costs are frequently blamed for the persistence of unemployment, usually coupled with criticism of the social protection system and of the high level of social charges. These critiques can confuse actual labour costs and *unit* labour costs (which correct for productivity differences), while incentives have to be taken into account, but the prescription is usually cost-cutting. But cutting wages and undermining labour market consensus are self-defeating if they reduce incentives, deter investment in human capital and create division. 'Competitive advantage' can, undoubtedly, be gained by paying yourself less, but is likely to be self-defeating if it amounts to a reduced standard of living. As the Lisbon Group (Petrella, 1995) point out, there is also a risk that an excessive pursuit of competitive advantage will damage the vulnerable and lead to a neglect of other policy aims such as sustainable development or redistribution. Cohesion is not just about equity (Begg and Mayes, 1993).

Competitiveness is most often discussed in relation to the tradable part of the economy, in particular manufacturing industry. This is a shrinking component of the economy in terms of shares of value added and employment. Squeezing large productivity gains from it may not be an ideal strategy. In the

short term, competitiveness depends on the structure of the economy and on its sectoral specialisation as well as contextual conditions such as the character and effectiveness of institutions, the quality and spread of infrastructure and other factors which influence the efficiency of the national system as a whole. In the long term, competitiveness depends on the ability to sustain change in the factors that give rise to productivity growth (technology, human resources, etc, but also the structure of the economy and how it policy seeks to shape it). Hence, investment (in human as well as physical capital) is important as well as institutional and organisational changes (Amin and Tomaney, 1995).

Improved economic performance can be achieved by a number of different approaches. The most obvious and enduring is to raise productivity, so that the ability of the economy to generate more output from a given supply of inputs is enhanced. But if output is the test of competitiveness, it can also be attained by activating otherwise unemployed resources. This suggests that the focus of attention should be both on capacity building and on capacity utilisation.

### **Definitions**

In practice, different definitions can be envisaged depending on the focus of interest. A *White Paper* produced in 1995 by the UK government offers this definition at the company level:

‘For a firm, competitiveness is the ability to produce the right goods and services of the right quality, at the right price, at the right time. It means meeting customers’ needs more efficiently and more effectively than other firms.’

For a nation, the OECD defines competitiveness as:

‘...the degree to which it can, under free and fair market conditions, produce goods and services which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long term.’

A study by DGIII of the Commission sets out a ‘competitiveness pyramid’ in which the top is the standard of living, dependent on the employment rate and productivity. There are then various factors which feed into each of these at lower levels of the pyramid. Thus, employment is influenced by various factors that affect the supply and quality of labour, such as demography, the participation rate and skills formation. Productivity is depicted as being influenced by both market performance and financial performance, with these in turn shaped by the likes of innovation, R&D, taxation, investment and other supply-side variables.

### **Influences on urban competitiveness**

However the term is interpreted, some cities manifestly ‘perform’ better than others in so far as the income and employment generated within their boundaries exceeds that of others. This suggests that the capacity of a city to compete is shaped by an interplay between the attributes of cities as locations and the strengths and weaknesses of the firms and other economic agents active in them. If markets worked perfectly, it might be expected that inter-city cost differentials would adjust to give rise to a pattern of exchange in which comparative advantage determined relative specialisation. This would, indeed, render the notion of competitiveness meaningless. The persistence of disparities in key economic indicators (demonstrated over the years in the work of Tony Champion, and also by Cheshire and Hay, 1989) implies, however, that there are systematic differences in the relative attractiveness of cities: in short that there are cumulative influences which transcend relative cost differentials.

Several authors have noted the increase over the last fifteen years or so in competition between cities to gain investment and to promote themselves (see, for example: Harvey, 1989; Butler-Jensen et al., 1997; and Cheshire and Gordon, 1995). This upsurge in spatial competition can be explained in a variety of ways (Jensen-Butler, 1997) and takes place across a wide range of policy areas, all of which point to facets of cities that affect performance and, arguably, competitiveness. It is widely

accepted that production – whether in services or in industry, is becoming more fragmented and footloose. Companies are able to choose more flexibly where they locate specific processes and can, consequently, select the locations that best suit each stage of production. This is especially true of the new, knowledge-based industries (OECD, 1997a) in which the agglomeration advantages of cities come to the fore.

Gordon and Cheshire (1998) suggest that ‘territorial competition may be conceived of as involving attempts by agencies representing particular areas to enhance their locational advantage by manipulating some of the attributes which contribute to their area’s value as a location for various activities.’ However, there are many possible sources of competitive advantage. Some will directly affect firms’ costs of operation and are, consequently, best analysed at the firm level. Competitiveness is, on the whole, reasonably well understood and accepted as a meaningful concept at the level of the firm. Firms seek to outdo their rivals by gaining market share at their expense and by improving the profitability of a given market share, although these two aims may be at odds for extended periods. It is open to question whether long-run profits, sales growth, shareholder value or some other variable is the primary motive of companies, and economic analysis has evolved increasingly complex models to capture these various phenomena.

Firms compete on the basis of price and non-price attributes of the products they sell and there tend to be systematic differences between industries and market segments in the relative importance of the two. Both price and non-price factors will, however, be influenced by the firm’s location. The direct cost of factor inputs will exert a strong influence on the prices that companies have to charge to be financially viable. Consequently cities where property costs are high or labour is expensive will, other things being equal, be at a disadvantage. Non-price factors will be much more diverse. The degree of congestion in transport systems, could, conceivably, affect commitments to timely delivery of products; lack of immediate or easy access to specialised business services might make it more difficult for a firm to upgrade quality or design; and so on.

These indirect costs represent a second level of analysis external to the firm. Gordon and Cheshire (1998) refer, in this context to the importance of the local ‘environment’, notably because it influences the willingness of mobile workers to locate in the city; and to the ‘*milieux* - external, unmarketed influences on the productivity, innovativeness and dynamism of local businesses’. The existence or absence of clusters of companies involved in particular industries and some of the other influences suggested in Porter’s ‘diamond’ model can also be considered relevant here. At the same time, the city’s history and its inherited mix of industries will have enduring effects on the city’s capacity to embrace new forms of activity.

A third level of analysis is governance and policy influences. Attitudes to land-use planning will bear on the types of economic activity that are able to flourish. Other forms of regulation will affect the ease with which business can operate, while also contributing to the physical and social environment. Public support is crucial in supporting cultural activities and, more generally, for developing the civic amenities that become key ‘assets’ of the city. The taxes and charges levied by the authorities and the cost-alleviating services they provide in return also contribute to the relative attractiveness of locations.

The urban system as a whole can also influence national competitiveness. Markusen (1996), in reviewing the inter-play between industrial and regional policy, notes that seeking to steer industry to less-favoured locations in order to fulfil equity aims, may prevent the realisation of agglomeration benefits or the attainment of economies of scale. But she also argues that capacity building may have long-term benefits in developing the urban system and encouraging a flatter urban hierarchy in which more cities offer a range of opportunities to firms. She cites evidence that ‘large and powerful oligopolistic industries, especially in mature or declining sectors, discourage entrepreneurship and restrict the supply of land, labour and capital to other industries.’ Specialisation is inevitable, but in the era of globalisation, will require fresh thought on the assets (and liabilities) of different cities.

Making effective use of urban assets requires that the differences as well as the complementarities of cities in the urban system be recognised and that there are gains to be achieved from exploiting the characteristics that distinguish cities and give them their identity.

#### *The urban dimension of competitiveness*

Kresl (1995) is one of very few authors to have tried explicitly to define competitiveness in relation to urban economies. He correctly stresses the need for care in the choice indicators used to measure competitiveness and makes it clear that the focus at the urban level may differ significantly from the national level. He cites six attributes which he considers signal a competitive urban economy, and deliberately includes qualitative as well as quantitative targets:

- The jobs created should be high-skill, high income jobs
- Production should evolve towards environmentally benign goods and services
- Production should be concentrated in goods and services with desirable characteristics, such as high income elasticity of demand
- The rate of economic growth should be appropriate to achieve full employment without generating the negative aspects of overstressed markets
- The city should specialize in activities that will enable it to gain control over its future, that is, to choose among alternative futures rather than passively accepting its lot
- The city should be able to enhance its position in the urban hierarchy' (Kresl, 1995: p 51)

This list constitutes an altogether richer notion of competitiveness than is afforded by looking at an income measure, productivity or some other single variable. There is, however, a risk of turning equating a competitive urban economy with an unattainable ideal state. Even if the list is broadly accepted, some thought needs to be given to how to weight the various targets in order to appraise the relative merits of progress on some fronts but not others. In the same way, it is likely that progress towards one target may impede advances towards another, and such a trade-off has to be looked at with care.

In attempting to explain the determinants of competitiveness, Kresl argues for a dichotomy between what he calls 'economic' determinants (factors of production, infrastructure and similar) and 'strategic' determinants, in which category he includes policy factors and institutional design. Conceding that the distinction may at first sight 'seem somewhat forced' he notes that the former group is composed of quantifiable factors, while the latter is qualitative.

#### *Links to specialisation*

Is it better to be active in the right sectors than competitive in the wrong ones? The objection of Krugman and others (see Krugman, 1996a) to the quest for improved competitiveness is that it takes insufficient heed of insights from the theory of international trade. Countries should, according to this logic, recognise where their comparative advantages lie, and should not try to divert from them. Instead, the best outcomes are achieved by allowing market forces to operate such that 'natural' specialisations result. Krugman, having been a leading figure in the development of strategic trade theory, argues that the transitory advantages of pursuing a strategic trade policy are outweighed by the longer-term distortions that such an approach introduces.

This contrasts with an intuitive view that, for a city to prosper, it is better for it to specialise in growing industries; that the future lies in being at the technological leading-edge, rather than stuck with mature technologies. In this regard, further complications arise in assessing competitiveness at different levels of aggregation: the company, the industry, the sector or the country as a whole. These will, inevitably, interact with one another, yet can be explored separately.

Cuadrado-Roura and Rubalcaba-Bermejo (1998) observe that cities have always specialised and that these specialisations are often at the heart of what distinguishes cities from one another. They note that specialisation can become damaging if internal or external factors result in a decline in the competitive position of the city or where, as they put it, 'international dynamics do away with the need for specialization'. More diversified - usually larger - cities can, however, compensate for the relative decline of some activities by growth in others.

Evidence of the development of local and regional clusters of activity shows that specialisation remains important. Porter (1996) makes the point that clusters do not necessarily emerge only in large cities or favoured regions. Nor are they confined to sunrise industries: he mentions Pittsburgh as an example a city in which a cluster of metal and material processing firms includes traditional steel-making companies, 'but also companies producing process automation software and advanced process equipment'.

### **3 Influences on urban economic performance: a schematic summary**

In an attempt to bring together the factors that affect urban economic performance, the different 'competitiveness' factors have been brought together in a schema shown graphically in figure 1. In this conceptualisation, the ultimate target variable is the standard of living, adjusted to allow for non-pecuniary influences on the quality of life. The welfare function is bound to include a list of variables and to be open to subjective weighting criteria, but it is not hard to imagine tensions between different objectives. Higher incomes plainly raise the standard of living, but would be offset by environmental degradation or threats to personal security.

The combination of employment rate and productivity is what generates output and thus income, although whether the income so generated stays in the city depends on the location of the owners of capital and the residence of workers. Urban performance, too, is multi-faceted and is linked in various ways with standard of living, employment rate and productivity. A 'good' performance may be recorded on, say, the number of jobs a city sustains, but this might not be matched either by income generation or improved equity.

On the 'input' side, the four categories of determinants draw on a format that will be familiar from the work of Michael Porter, but differ to the extent that the focus here is on variations across cities rather than nations. Some are mutually reinforcing, others contradictory; certain characteristics may be favourable for a period, but turn sour subsequently. They are:

*Sectoral trends* which captures the main influences on the structure of economic activity in a city and the consequent prospects. These factors are shaped partly by the city's inheritance: the mix of industries and functions will be the outcome of historical development. These in turn will be affected by the incidence of 'top-down' policy influences.

- Thus, the aggregate performance of the national (and, increasingly, the European economy) is bound to affect the individual city.
- Long-term structural changes will affect the health of the industries prominent in the urban economy. These will change through time, but usually quite slowly.
- National policy changes, too, will impinge on what the city is able to do. A rise in interest rates, for example, will typically hit firms which depend on consumer spending. Exchange rate changes affect trading companies and so on.

*Company characteristics* refers to the mix of attributes of the companies in the local area. Are they, on average, dynamic or sluggish, financially robust or precarious? Do they have access to efficient financing or are they reliant on costly capital? Plainly, an urban area with dynamic companies, selling in growing markets and with strong growth potential will tend to perform better. Key facets of this will include:

- Ownership and decision-making powers. Cities with a preponderance of indigenously owned companies will, *ceteris paribus*, be more competitive than those where external control dominates. This is by no means a blanket conclusion. External ownership may be unambiguously beneficial if the inward investor maintains capital spending and steers orders to the locality. In addition, 'embedding' can secure many of the presumed benefits of ownership by enhancing the decision-making powers of urban economic actors.
- The size mix of companies which, in combination with sectoral mix, will bear on how competitive companies are. SMEs constitute a second source of potential competitiveness. Rapid start-up rates and high survival rates are desirable characteristics.
- The market segments in which there is relative specialisation: up-market or low-brow; declining or growing, etc. The breadth and quality of the supply-chain is often seen as an advantage of agglomeration, but can equally be seen as having an effect on the ability of the urban area to compete. Moreover, a high and growing proportion of trade is within the organisation or in tightly-knit supply chains.
- Allied to this is the nature of financial intermediation: risk taking or risk averse?

*The business environment* comprises those factors outside the direct control of the firm, but which exert a significant influence on the attractions of the locality as a place of business by affecting the ease with which business can be done. Many of the most telling influences on urban competitiveness concern the mix of factors that affect the input costs of employers in the urban area. Some of these can shift from being favourable to adverse fairly quickly as circumstances change. Thus, if there is a good stock of desirable property which draws in investment and raises rental values, but there is negligible scope for new property development, the outcome could be to undermine the initial locational advantages. Key factors here include:

- The supply, quality and cost of the various factors of production, i.e. different categories of labour, property and complementary services.
- Labour supply in turn is shaped by the education and training facilities and the ease with which companies can alter the nature of publicly funded training provision
- Fiscal and user charges can vary substantially between cities, as can the benefits or costs of local public spending. Physical planning rules have similar effects
- Social and environmental factors, such as the quality of residential accommodation, the crime rate, schools and so on will play a significant part in persuading investors and senior managers to select a city to invest in. The availability of civic amenities can be expected to work in a similar way.
- More generally, 'social cohesion' is regarded as a favourable aspect of a locality and careful integration of social and economic objectives can assist regeneration (Mier, 1993).
- Various agglomeration effects can be envisaged. Positive ones include the diversity of sub-contractors, while congestion can be adverse. These are linked to the quality and cost of the transport, communication and other infrastructure networks.

*Innovation and learning* refers to those factors that inhibit or encourage the capacities of firms to develop new processes and products. Investment in intangible assets such as knowledge, or encouragement of the propensity of the local area to foster entrepreneurship, especially in technologically advanced areas, will be important. The hardware and software that, together, provide the tools of the computer age have, it is argued, to be complemented by brain-power or, as some put it 'wetware'. Innovation (software) and learning (wetware) are, thus, important facets of the competitive position of cities. These are increasingly being recognised as crucial to successful urban development (see the work of Cooke and Morgan, 1994). Much of the impetus to innovate or learn will come from within the company, but there will also be tangible external influences. Thus:

- Access to various kinds of networks make it easier to learn of opportunities, to compare notes and to benefit from the experience of others.
- In a related way, if there is pressure from exacting purchasers, quality enhancement is likely to be achieved (one of Porter's key factors).
- The availability of research support, whether in the form of publicly funded research institutes or universities interested in assisting business, or a range of consultancy expertise are likely positive factors here.

Various feedback mechanisms also need to be taken into account. For example:

- Success in attracting inward investment will tend to accelerate structural change, but may also accentuate congestion.
- If low property costs attract business, rising rents may have the reverse effect.
- If there is a strong propensity to innovate this may also spawn new starts in dynamic sectors, producing a clustering (growth pole) effect.

#### **4 Policy issues**

Although there are critical influences on urban competitiveness that are beyond the control of urban policy-makers, they need not be passive actors. 'Good' policy can equip cities to adapt and to foster a dynamic economic environment; ill-judged policies can deter investment and trigger cumulative forces that lead to relative decline of the sort that has been evident in so many parts of the industrialised world. Equally, there are many ways in which the performance of the urban system as a whole and of cities that provide strategically important links in the national economy impinge on national competitiveness.

The foregoing discussion points to a range of supply-side factors that shape urban economic performance and can, therefore, be seen as amenable to policy action to boost competitiveness. With the (limited) exception of public purchasing by sub-national government, the key demand side factors cannot, by contrast, be deployed at the urban level. Macroeconomic policy variables that bear on regional economic performance, such as the interest rate, monetary growth or the fiscal balance which influence the exchange rate, the cost of capital and wage inflation are set at national or, increasingly, supranational level. The choices on these variables will not necessarily reflect the short- to medium-term needs of individual cities or regions, being aimed essentially at stabilisation objectives.

In assessing the new demands on policy, two emerging trends have to be accommodated. On the one hand, globalisation limits the freedom of manoeuvre of individual government at whatever level of governance, obliging them to moderate regulatory demands and tax rates. On the other hand, changes in the organisation of production which have seen new forms of co-operation alongside more extensive competition in many areas, blurring the boundaries between bundles of assets that comprise separate firms. Clusters of firms in similar activities have been recognised as having the potential to aggregate to more than the sum of their parts because of various spillovers, and it is arguable that the complementary assets of the city complement these private assets.

Porter (1998) argues that 'old distinctions between *laissez-faire* and interventions are obsolete. Governments, first and foremost, must strive to create an environment that supports rising productivity.' [xxiii] He also explicitly calls for government to recognise that social and economic policy must act in concert, rather than be seen as separate boxes: 'Educated citizens who are healthy and work in a safe environment are necessary for productivity.' [xxiii] Obvious, even banal, though these sentiments are, their implications for urban policy deserve attention. Limiting discussion of competitiveness to aggregate measures of productivity or the real wage may, however, be to miss a trick. Rather, the inter-action between policies pitched at different levels and their effects, on the one

hand, in boosting the performance of individual cities, and on the other hand, in enhancing the supply-side of the national economy deserve attention.

With this in mind, the key question becomes how policy responsibility for enhancing competitiveness should be assigned between tiers of government. There is a growing recognition that the characteristics of cities and the manner in which policy action affects these are critical determinants of economic performance (for example, the studies in Pyke and Sengenberger, 1992 or Amin and Tomaney, 1995). There are, however, unresolved questions about the degree to which it is desirable to devolve responsibility for economic development policy, and the city level is, plainly, one of the options. The trouble is that the policy instruments available to urban authorities often fall short of what is needed to implement meaningful reforms.

### **Competition between cities: policy implications**

The competitive ethos is, increasingly, affecting cities, obliging them to be more active in marketing themselves and in trying to identify and reinforce their assets (Gordon and Cheshire, 1998). There has been an upsurge in competition between sub-national territorial units as they struggle to gain an advantage in attracting investment, in stimulating expansion of new and existing firms and in boosting the quality of indigenous factors of production. Moreover, wasteful competition between cities can occur; equally, some of the success stories in recent years have shown the scope for imaginative policy at the city level (see, for example, the study of Chicago reported by Mier, 1993). In some countries, notably the UK, competition has, in turn, become a feature of policy-making through bidding systems such as City Challenge. Whether or not these shifts in philosophy provide lasting benefits either for needy groups or for the overall regeneration of cities is a question that concerns some commentators (Stewart, 1996).

#### *Why devolve?*

The changing environment has made policy assignment decisions that much more difficult. Of importance in making these decisions is the extent and nature of the externality and the extent to which a policy defines the jurisdiction, be it sub-national, national, or supra-national. Clearly the increased internationalisation in many areas has substantially raised the extent of spillovers and a response to these spillovers at the supra-national level is, in many cases, essential. Increased integration also limits the effectiveness of macroeconomic stabilisation policy at the national level, because the loss of monetary policy and the openness of economies that make counter-cyclical policies at a decentralised level much less effective. That puts the onus much more on supply-side policies.

A decision to decentralise will inevitably be taken on the basis of a cost-benefit trade-off, rather than the demonstration of an unambiguous superiority of governance by the lower tier. A number of different reasons for decentralisation of government powers can be put forward.

- A first is the attempt to achieve more efficient targeting of policy by customising public service delivery to the needs and priorities of the resident population. In the EU, with its diversity of populations, such a consideration is bound to be powerful.
- Because local and regional economic structures differ significantly, differences in approaches to regulatory controls are warranted.
- Policy innovation is encouraged by decentralisation, the more so where there are variations in the mix and character of economic agents. This is stressed in the literature on 'industrial districts' (see, for example, Pyke and Sengenberger, 1993). For policy areas such as regeneration, it is particularly important to take account of these economic structures, and this points to one explanation for the shift from the nation-state to lower tiers in this domain.

A key policy problem is how to distribute policy 'functions' between tiers of government. The following policy functions can be distinguished:

- Funding of the programme or the budgets of the agencies delivering the policy. There is no compelling reason to assign this to a particular governance level, although the linked issues of accountability and evaluation may have some bearing on the choice.
- Formulation of programmes and the adoption of policy instruments can benefit from both top-down and bottom-up inputs, so that there is, again, no strong prior.
- Delivery is the function where the case for being close to policy 'clients' is most persuasive, because this is the context in which local knowledge and identity can be expected to improve quality. Similarly, knowledge of local priorities can lead to better customisation of programmes or policy instruments, including experimentation with new schemes or innovative approaches.
- Co-ordination is required both between programmes affecting a particular area, and between areas to ensure that spillover effects are accommodated or duplication is avoided. The former is probably best achieved by the same tier as is responsible for delivery, whereas a higher tier is needed for the latter. Co-ordination also implies the setting of eligibility rules, where a higher tier has to be the prime mover.

### **Policy at the urban level**

What, then, can cities do to boost competitiveness? As the various contributions to OECD (1997a) make clear, the role of government is undoubtedly shifting from direct provision to an enabling one. Where public intervention is most successful, this tends to be attributable to effective infrastructure, policies which enhance the quality of labour, and the promotion of appropriate specialisation and economic linkages.

Kresl (1995: p 66) is sanguine: 'the individual city's government and private sector entities can do a great deal to enhance that city's competitiveness and to enable it to achieve the most desirable economic future possible.' Following the logic of figure 1, the main scope for action by urban policy-makers is in enhancing the business environment, fostering innovation and learning and assuring social cohesion. Duffy (1995) stresses that wealth creation in cities will be business led and that spending and other restrictions will curb some of the public-private projects that proliferated in the 1980s. She asserts that 'city governments are having to concentrate on the core job of providing services.

Duffy believes that the role for policy is to 'provide the basic blocks on which the business sector can build'. Her building blocks include training, aimed especially at supplying the vocational skills employers need to add value; improving the built environment; fostering inclusiveness of all social groups; and dealing with counterparts elsewhere. Implicitly, the last of these points towards recasting governance in a multi-tiered system. The trouble is that, with few exceptions, central government has tended to view city governments with suspicion rather than trying to devise optimal policy assignments. Finance, inevitably, is one bone of contention, but institutional rivalry is also evident.

Kresl, too, advocates sticking to the basics 'investment in infrastructure and human capital, promotion of smaller firms, ensuring an adequate complement of business and financial service providers, articulation of a well-thought-out and clearly expressed strategic plan, effective governance, and a supportive regulatory environment.' Here again, there will be few dissenters from the menu: the challenge is how to cook the dishes to make them palatable and satisfying. There is no single formula, although it is plain that urban authorities need to look beyond traditional policy instruments such as planning controls, social initiatives, housing developments and the provision of training and associated infrastructure. There is also a need to recognise that the possession of intangible assets - knowledge and the ability to use it being central - are vital ingredients in the competitiveness of 'new' activity, notably in IT-related industries. In this regard the propensity to innovate is important in generating advances, and small firms are one of the obvious mechanisms which promote innovation. But diffusion of knowledge, especially towards established firms whose growth provides the volumes of employment and value added that contribute to the desired outcome measures. Drake (1997)

distinguishes four strategic approaches to securing improved competitiveness in the context of the 'knowledge-based economy':

- market reliant
- market regulating
- market implementing
- market displacing

Changes in the business environment have to be achieved to accommodate the information driven economy (Drake, 1997). This requires much more of a partnership approach between government and increasingly nimble private sector agents. In cities, Duffy (1995) argues, officials and politicians need to do more to involve sectoral interests. Co-ordination between groups with very different institutional arrangements is a key issue here, leading Duffy to advocate what she calls "civic co-operation". Encouragement of partnerships at local level is one facet of EU funding through the Structural Funds that is seen as having made a positive contribution to the regeneration effort (Begg, 1997).

## **5 Concluding remarks**

Plainly, cities compete. They do so internationally, nationally and at the regional level, so that it is, *pace* Krugman, appropriate to explore the determinants of urban competitiveness. Equally, cities co-operate through specialisation and exchange of goods and services, and as components in an urban system that increasingly, transcends national borders. Co-operation is also evident in the articulation of common problems such as social exclusion or environmental degradation, sharing of experience and the establishment of policy networks.

As collections of assets, cities differ markedly. Some are well-equipped to compete in the new knowledge-intensive industries and thus to develop new strengths. Others will struggle and will need a concerted policy response to help them adapt, recognising that adaptation may include relative decline. Differences between cities in rates of innovation or implementation of new technologies can also be observed, suggesting that there are significant differences in the economic environment. It would be expected that many of these would be amenable to policy action and that properly thought-out initiatives could improve economic performance.

A conclusion emerging from many directions is that policy-makers will have to pay more heed to regional and urban dimensions of economic development policy (Markusen, 1996; Jensen-Butler et al., 1997. Reflecting on the experience of Route 128 and Silicon Valley, Saxenian (1996) maintains that 'regional policy is likely to be as important as macroeconomic or sectoral policies to maintaining industrial competitiveness in the 1990s. She argues that the key is 'creating institutions that promote a decentralized process of industrial self-organization without sacrificing individual autonomy or flexibility' and that the regional level is most appropriate for achieving this.

An effective urban system ought to have benefits for the economy as a whole. Thus, to the extent that the pursuit of urban competitiveness manages to be more than a zero-sum game, it can contribute to improved overall economic performance. But there are risks that resources will be squandered and market-led advances inhibited. Finding a way through the competitiveness maze to arrive at optimal policy structures and sensible policy choices for the economic development of cities will, consequently, take imagination and leadership at all levels of governance.

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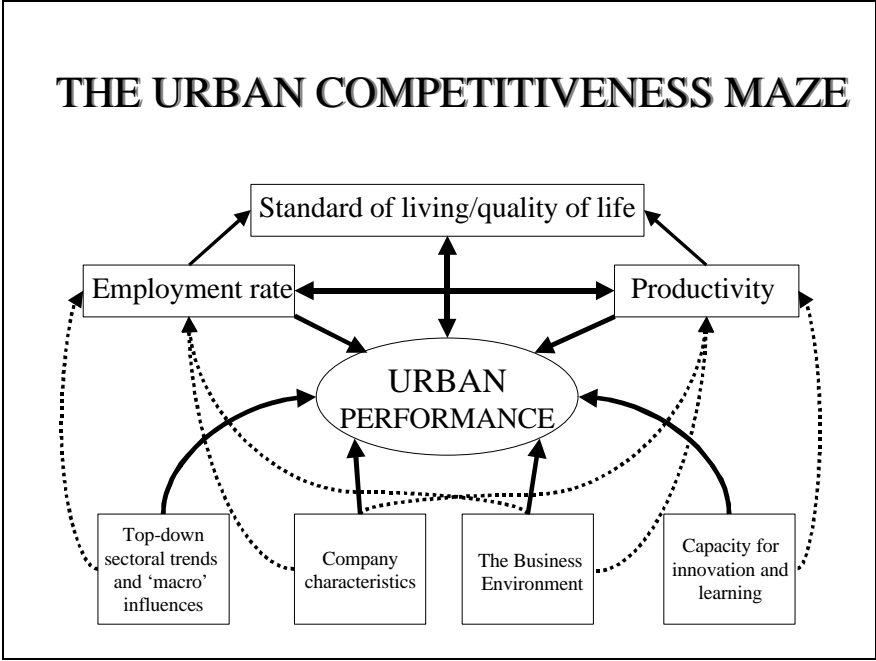


Figure 1